

plus 40 new cable programming services (i.e., none is in CFA's top 30), the operator cost of which is \$.25 per subscriber per service. The total programming costs are thus \$12.50 per subscriber.

As the initial step in the regulatory process, CFA would calculate the 1993 basic per channel rate as the 1986 basic price divided by the number of activated channels in 1993, or \$.20 per channel (\$10 divided by 50 channels).²⁴ One interpretation of the CFA recipe is that the maximum price that could be charged for the 50 services is 50 times the per-channel price of \$.20, i.e., the \$10 charged in 1986.²⁵ As

23 (Footnote continued)

currently bundle basic service and equipment and those that do not. As Besen et al. demonstrated in TCI's initial comments, failure to account for this distinction results in misstating what the "benchmark" rate should be. Besen et al. at 18-20.

24 This is RCB93 in CFA's "formulaic," which, as a result of our assumption of no inflation, is also equal to RC93. CNL93 equals 50 and the ratio (CNL93/CNLN) in the RCBN calculation equals one, because here we are looking at what rates the system would be able to charge in 1993 according to the CFA formula.

25 There is some confusion about the calculation because CFA defines the maximum monthly bundle price as TBB x RCB93, where TBB is defined as must-carry stations plus the highest number of top 30 cable programming services carried between 1986 and 1992. Taken literally, this would mean in our example that the maximum price that could be charged for the 50 services would be \$.20 times 10 services or \$2. The description in the CFA recipe goes on to "NOTE THAT TBB INCLUDES ANY CHANNELS BUNDLED OR TIERED WITH [TOP 30] PROGRAMS." It is not clear

(Footnote continued on page 23)

we shall see, this ceiling will never be reached.

The permitted price for the basic service component of the bundle of 50 services would depend on the number of top 30 services on the basic tier in 1993 relative to the total number of channels offered on basic at the time that carriage of the top 30 services was at its 1986-92 peak. CFA includes this provision to discourage operators from reducing the number of cable programming services on basic (again, a goal inconsistent with the statutory scheme). But, in fact, carriage of exactly the same services on the basic tier in 1993 as in 1986 will reduce the total rate charged for those services far below the 1986 levels.

Under the CFA formulaic, if basic service in 1993 looked no different from that in 1986 (i.e., half the ten 1986 basic channels were occupied by five of the top 30 services), the operator would be able to charge only \$.10 per channel (i.e., half of the per-channel rate), or \$1.00 per subscriber per month for the basic tier.²⁶ For the remaining 40 services,

25 (Footnote continued)

whether in our example TBB would be 10 (the number of must-carries and top 30 cable programming services carried in 1986) or 50 (the total number of must carries and cable programming services carried in 1993). We assume the latter in the text.

26 In the CFA formulaic, the per-channel price (\$.20 in our example) is reduced by the ratio of the number of top 30 services carried on basic to the total number of basic

(Footnote continued on page 24)

all of which are carried on a second basic tier, the operator would be permitted to charge \$.20 per channel, or a total of \$8. For a household subscribing to both tiers, the monthly charge would be \$9. Thus, per-subscriber revenues are reduced from their 1986 levels despite the increase in quality.²⁷

Under CFA's approach, the cable operator carrying 50 channels in 1993 would not even be able to charge the same price it charged in 1986 for 10 services. While the maximum CFA would permit the operator to charge is \$10 for all 50 services, in fact that maximum will never be reached because must-carries are priced at zero under the CFA formulaic. Moreover, when the operator offers a 1993 basic service consisting of the five must-carries and five top 30 services and a second tier consisting of the 40 new cable programming services, the total programming cost (\$12.50) cannot be recovered at that \$8 price. As a result, the operator will be compelled to select programming whose average cost is no

26 (Footnote continued)

channels offered when the carriage of the top 30 services was at its peak. Here, this ratio is .5 (5 top 30 services divided by 10 channels). In the jargon of the CFA formulaic, $PQI=.5$, $RCB93= $.20$, and the number of basic channels is 10.

27 If the operator desired to offer all 50 channels on basic service, then the price of that basic service according to the CFA formula would be \$5 (i.e., \$.10 per channel times 50 channels). TCI notes again here that the CFA approach is at odds with the statute for its indifferentiating treatment of basic service and cable programming services.

greater than the \$.20 price per channel that the CFA permits.²⁸ And the operator will not add any more services unless the additional cost per service (including billing, promotional, and channel rearrangement costs) is no greater than \$.20. Further, the operator will have an incentive to keep any top-30 services on the basic tier only if the cost of the service is (in our example) less than \$.10. Over time operators would replace any relatively expensive top-30 service with less expensive new services. Alternatively, some of the top-30 services may reduce their costs and quality to satisfy the constraints imposed on them by the CFA formulaic.

The one and only way in which the operator can raise the permitted price per channel and increase net revenue is by reducing the number of activated channels. In the example above, the operator could delete the five top 30 services on the basic tier while continuing to offer a second tier with the 40 new services. In this case, the permitted basic price would be zero and the operator could charge \$8.80 for the remaining package of cable programming services (i.e., 40 times .22).²⁹ The operator would have given up the opportunity to charge an

28 The amount that would actually go to programmers would be even less because these average costs will include billing, promotional, and channel-rearrangement costs as well as programming costs.

29 If the operator deleted the five services from its lineup, it would have 45 activated channels. In this case, the CFA-permitted price per channel would rise slightly to ($\$10/.45$) or \$.22.

additional \$1 for basic service, but would have saved \$2.50 in programming costs and could raise the "second tier" price by \$.80.³⁰ Indeed, the system can double its permitted price per channel for cable programming services by reducing the number of activated channels to 25. In short, the operator's profits can be raised by reducing service quality from its 1993 levels. Thus, the CFA formulaic will result in the very quality degradation that CFA asserts its proposal will avoid.

Among others, one reason for this odd result is either the presumption that per-subscriber costs, including programming costs, have not increased since 1986, or that regulation of cable systems will have little if any effect on the availability of cable programming services. Both presumptions are simply wrong. The ratecard charges for the most popular satellite programming services have risen by over 75 percent after accounting for inflation.³¹ And, as Besen

30 Another omission in the CFA formulaic is how often the formulaic is to be revised. As in this example, the formulaic seems to suggest that any time additional channels are activated, the per-channel price must be reduced in order to maintain a ceiling on the total rate for basic and cable programming services equal to the 1986 rate for basic service (after accounting for inflation).

31 According to Cable TV Programming (March 25, 1991), the 1986 average ratecard per-subscriber fee charged cable operators for cable programming services (excluding superstations) was \$.085; the corresponding figure for 1992 (as estimated in the publication) is \$.173. Thus, in nominal terms, the average ratecard fee rose by

(Footnote continued on page 27)

et al. discussed, the economic history of the cable industry suggest that program availability is very sensitive to rigid regulation. Besen et al. at 6-14.

The CFA formulaic also presumes that it is costless to activate additional channels and that there are no costs of maintaining the cable plant, or of maintaining a depreciation reserve for plant rebuilding and improvements. This is most apparent if all that is offered on basic service are local broadcast stations. According to CFA, the permitted price for such a package would be zero. If the per channel variable costs for some channels exceed the CFA-permitted price (excluding programming, billing, promotional, and channel rearrangement costs), operators would reduce the number of channels offered. In the longer run, the CFA formulaic will discourage plant replacement, additions and improvements.

In addition, CFA also proposes to reduce the per-channel rates by the amount of per-channel advertising revenue earned by the operators industry-wide. The effect of such an "adjustment" will be quickly apparent. Because individual cable operators cannot affect that industry-wide average, it will not affect any operator's advertising efforts.

31 (Footnote continued)

103 percent. Between 1986 and 1992, the Bureau of Labor Statistics informs us that the Consumer Price Index for entertainment rose by about 28 percent. Thus, the 1986-92 inflation adjusted increase in the average ratecard fees is 75 percent.

The sole effect of the advertising adjustment is to lower the basic rate even further below the 1986 rates. In effect, the operator will treat this requirement as "tax" on its cable service, further reducing the amount that it is willing and able to pay programmers. The CFA proposal contravenes both the statute and good policy.

b. NAB's Benchmark Approach Should Not Be
Adopted By The Commission

In an attachment to NAB comments, NAB's economists provide a brief description of the dangers of conventional cost-of-service regulation and of some of the advantages of a benchmark approach, while voicing concerns about avoiding a regulatory regime that will impair the quality of service offerings.³² At the outset, one might well wonder why NAB would be so interested in the precise form of rate regulation for cable systems. If in fact the primary result of cable deregulation was the exploitation of consumers by charging them supracompetitive prices, presumably fewer households would subscribe to cable, making the broadcasters better off. However, the fact that the broadcasters seek more onerous regulation suggests that cable deregulation led to an improvement in the quality of cable programming services

³² See Haring, Rohlf and Shooshan, "Efficient Regulation of Basic-Tier Cable Rates" (Jan. 26, 1993) submitted as Appendix A of comments of NAB.

available to subscribers, generating subscribership increases and therefore leaving fewer households captive to broadcast stations. Certainly, the post-deregulation decline in the viewership share of over-the-air television is consistent with this suggestion. By proposing regulations that will artificially depress the price of basic service below its costs, NAB's economists ensure that those costs will have to be recovered in higher prices for cable programming services, both reducing the number of subscribers to these other services and reducing the revenue base for improvements in cable programming service. The broadcasters here are not helping consumers, but helping themselves by reducing the attractiveness of cable service.

The NAB economists describe a self-described "simple" benchmark approach for the regulation of the basic service tier.³³ Under their scheme, the Commission would determine that portion of the basic rate that would be based on the cable system's capital costs, as measured by replacement costs. NAB, Appendix A at 6. Other costs -- notably programming costs "and other expenses" -- would be passed through directly to consumers, if approved by the local franchising authorities.

³³ It appears from their attachment that the NAB's economists intend to offer a prescription only for the regulation of basic service tier rates. They thus appear to have avoided the fundamental error of the CFA proposal.

NAB's appreciation of the costs of cost-of-service regulation is, unfortunately, short-lived. With respect to the measurement of system capital costs, rather than advise the Commission as to the appropriate way in which replacement costs could be reliably estimated, they tell the Commission that the way to get the job done is to go and do it.

The basic task is to determine how much it would cost to replace existing plant with new plant that could perform the same functions . . . A benchmark for the amount of capital should be based on statistical analysis of relevant economic and engineering data. Benchmarks should be developed for multiple categories defined in terms of [relevant] factors . . . The unit cost of capital consists of depreciation, return on capital (including interest and return to equity) and taxes. The appropriate depreciation rate is the expected decline in the real replacement cost of the plant. The depreciation rate should reflect technological obsolescence as well as physical deterioration. The appropriate return on capital for replacement cost regulation is the real cost of capital. This equals the nominal cost of capital less the expected inflation rate. Taxes must also be factored into the benchmark for capital costs.

Id. at 11-12. What NAB's economists have offered the Commission are the standard textbook principles for cost-of-service regulation. But as NAB's economists note, "If it ain't feasible, it can't be optimal." Id. at 1, n.1. NAB's economists have provided the Commission no guidance as to how to resolve the measurement difficulties that permeate every aspect of their proposal.

To begin with, NAB's economists presume that measuring replacement costs for systems that vary widely in their characteristics is quite straightforward, apparently basing their assertion on the earlier work of Shooshan and Jackson on q-ratios sponsored by another strategic opponent of the cable industry -- the telephone industry. Id. at 6-7. These economists can only be considered to be correct about the ease of the task if the Commission is indifferent to doing it right. The implication that the estimate of replacement costs used in q-ratios designed by Shooshan and Jackson can be used to set the precise capital cost component of basic service prices is simply incorrect. The competitive value of a cable system is more than the cost of the cable and the associated labor required to wire a franchise. It also consists of the costs of planning, the costs of training personnel to deal with franchise authorities and with consumers, the costs of promoting the existence and the offerings of the cable system, the costs of developing a sound reputation with consumers, the costs of searching out new program sources and means of distribution, the costs of assembling the management team to coordinate all of the start-up and ongoing activities of the cable systems, and a myriad of other costs that are lumped together as "intangible assets" or "goodwill."

Thus, one economic expert recently noted that the "measurement of the replacement cost of intangible assets is an enormous task that requires gathering a massive amount of data

and using sophisticated economic analysis to arrive at an estimate of replacement costs. To design the appropriate surveys, gather the data, develop the economic analysis, and then analyze the data would take years to complete."³⁴ Another economist also recently observed that attempts to estimate replacement costs flew in the face of "decades of literature showing the near-impossibility of defining it clearly or estimating it reliably."³⁵

With regard to the estimates of Shooshan and Jackson in particular, Professor Grossman noted that "the size and difficulty of the task of calculating the replacement cost of intangible assets is simply no excuse for assuming this replacement cost is zero. Nevertheless, by excluding these assets from the replacement cost of the firm, Shooshan and Jackson have assumed that replacement cost [for intangible assets] is zero."³⁶ In the technical appendix attached to their current paper that provides an example of how easy it is to estimate replacement costs, NAB's economists are true to

34 See S.J. Grossman, "On the Misuse of Tobin's Q To Measure Monopoly Power" at 11 (1990) ("Grossman"), attached to Comments of the National Cable Television Association before the Commission in Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Dkt. No. 89-600 (Mar. 1, 1990).

35 W.G. Shepherd, "Tobin's q and the Structure-Performance Relationship: Comment," 76 American Economic Review, 1206 (Dec. 1986).

36 Grossman at 11-12.

form: There is no mention of intangible assets. Therefore, it is hardly surprising that these economists derive a very low price for basic service.

The Commission itself has noted that while the q-ratio may be a useful indicator of market power, it is subject to some "conceptual and important measurement problems."³⁷ It later observes that "even if one were confident of the market value and replacement cost estimates, additional assumptions and a substantial amount of additional analysis would be needed to translate the findings into information about how far cable rates diverge from the competitive level." Id., App. E at 5073.

Some of these additional tasks are listed summarily by NAB's economists in the excerpt above. The Commission's own telephone regulation experience gives it full knowledge of the difficulty of not only determining the appropriate rate base, but also the contentiousness, the uncertainty, the required resources and the lengthy amount of time involved in estimating the "right" rate of return, the "right" rates of depreciation and technological obsolescence, and the "right" treatment of taxes.³⁸

37 Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, 5 F.C.C. Rcd 4962, 4997 (1990).

38 The last major cost-of-service proceeding the Commission undertook was in Docket 19129, more than 20 years ago.

As difficult as it is to perform these tasks for one system, NAB's economists are apparently proposing that replacement costs be estimated for a number of system categories. While not discussed by NAB's economists, there appear to be two possible approaches to the estimation process. One would be to estimate the replacement costs in each category based on a sample of real-world cable systems for each category. This would require, in effect, a rate-of-return proceeding for each system in the sample.

A second approach would be to ask an engineer to design the "optimal" cable system for each category. Needless to say, the belief that an engineer can replicate the outcome of entrepreneurial behavior is one that disappeared along with the Berlin wall. The system resulting from such an exercise would be one that only a determined central planner could love.

Under either approach, the effort would likely endeavor to incorporate "best-practice" technology into the cable systems it designs. Here, too, the shortcomings would be demonstrably costly. The technology of video delivery is in a rapid state of change. What is best practice today may well be obsolete tomorrow. If adopted, the proposal of NAB's economists would freeze technology at its current level, depriving consumers of the benefits that this new technology may bring.

In short, NAB's economists have failed to inform the Commission how the task of estimating all of these components

can be accomplished with a minimum of resources, in a relatively short period of time, and with an associated outcome that is reasonably accurate for cable systems. Despite the rosy projections of NAB's economists, this approach would likely result in the same administrative quagmire as any other rate-of-return proceeding, with no reasonable expectation that the game would have been worth the candle.

NAB's economists seemingly propose to let the local franchise authorities decide whether and which increases in non-capital costs can be passed on to subscribers. As Besen et al. earlier noted, each franchise authority has an incentive to shift costs to all other franchises. Thus, a franchise area served by a system operating in more than one area may not approve of any cost pass-throughs, anticipating that its refusal will simply increase the costs incurred by subscribers in other franchise areas or will have little effect on the quality of services offered. Of course, if all franchisors behave in this way, the cable system will be forced to reduce the number or quality of services, thus rendering cable service less attractive to households. Presumably, the broadcasters would find such an outcome neither unwelcome nor a surprise. Fortunately, the Commission's statutory goals require a more wholesome result for cable subscribers.

The problems inherent in the NAB scheme are most readily apparent in their proposed calculations. The numbers produced in the chart at the end of the NAB's submissions do

not pass even the most superficial "eyeball" tests: the operating costs of serving subscribers from one area to the next are shown to swing wildly from 69¢ up to \$4.56 (a swing of nearly 600%), an inherently implausible proposition. While TCI has not attempted to review every error, it notes a handful of patent flaws:

- The Comcast/Philadelphia system numbers are divided by the total number of Comcast subscribers. Utilizing the correct subscriber number changes Shooshan's 69¢ figure to over \$11.00.
- The Falcon expense and subscriber numbers are similarly mismatched. The Falcon subscriber number is off by nearly 900%.
- Lacking overhead expense figures for Falcon, Shooshan assumed them to be zero.
- The rate of return applied (8%) is nearly half that permitted to the entrenched telephone monopolies.
- No intangible assets have been included in the cost figures. Under this analysis, broadcasters should be required to sell their properties for no more than replacement costs of the physical assets, a result we suspect they would find unappealing.

Any one of these errors is enough to discredit the overall effort. It also shows graphically the fundamental problem with the suggested approach: it permits, indeed invites argument and controversy over every aspect of cable costs. It should be rejected out of hand by the Commission.

c. City of Austin et al.'s Approach Should
Not Be Adopted By the Commission

The Comments of the City of Austin et al. contain the worst of the proposals of NAB's consultants and CFA, and then go them one better. Like CFA, the City of Austin et al. apparently has no appreciation of how cable service has changed during the past 8 years. Like NAB, the City of Austin et al. proposes a regulatory scheme in the form of a benchmark, but one that requires in effect rate-of-return/rate base proceedings for a number of system classes. And like NAB's economists, the City of Austin et al. concludes that basic and expanded basic rates could be far lower than is currently the case or those recently proposed by TCI, a conclusion premised on the assumption that anyone with an IQ greater than the number of local over-the-air stations can plan, design, construct, and operate a cable system. In apparent recognition of the exhaustive effort their scheme will require for its actual implementation, the City of Austin et al. propose additional interim rates that simply fail to pass any laugh test.

The City of Austin et al.'s proposal is based upon work done by Smith and Katz,³⁹ which evinces an equally

³⁹ J.C. Smith and M. Katz, "Analysis for Cable Television Rate Models and Proposal for Development of Cost-Based

(Footnote continued on page 38)

monolithic obsession with low rates without any regard to service quality. These accountants conclude that the most significant factor explaining the increase in the price per subscriber paid in the sales of cable systems since 1984⁴⁰ is the rise in the rates charged cable subscribers.⁴¹ It apparently never occurred to them to ask why, if effective rates are rising, cable penetration is also rising.⁴²

In a similar vein, Katz and Smith compare the rise in basic rates with the relative constancy of the pay rates,⁴³ suggesting that the constancy of pay rates is due to competition among pay services and the competitive pressure resulting from video cassette sales⁴⁴ But pay rates are per channel rates, and if Katz and Smith had similarly calculated the change in the per-channel price of basic service, they

39 (Footnote continued)

Industry Norms," (Jan. 27, 1993) ("Analysis for Cable"). Submitted in the instant proceedings with the comments of City of Austin, et al.

40 See Analysis for Cable, Appendix B at Exhibit B-2.

41 They reach a similar conclusion in calculating the increase in the value of cable systems' intangible assets.

42 Katz and Smith also fail to correct their data for changes over time in the kinds of systems that were sold. Indeed, it was during this time period that many of the more valuable franchises (particularly in urban areas) were built and subsequently sold.

43 See Analysis for Cable, Appendix B at Exhibit B-1.

44 See id., Appendix B at 2.

would have observed a decline because the number of services offered on basic -- one measure of the quality of basic -- was increasing more rapidly than was the price of basic service.⁴⁵

That Katz and Smith share with CFA the failure to appreciate the subscriber benefits of deregulation is most evident in their proposal to regulate the price charged for cable programming service as rigidly as that for basic service. As TCI explained in its discussion of the CFA proposal in Section III(A)(1)(a), supra, such treatment contravenes the statute, and moreover, is certain to reduce the quality of cable service and therefore the value consumers place on cable service.

Like NAB, Katz and Smith respond to the Commission's challenge for an easily administered and consumer-friendly method of regulation with a green-eyeshade call to rate base/rate-of-return benchmarks based on apparently "ideal systems" for various categories of cable systems. And they

⁴⁵ Besen, et al. at 13. Elsewhere, Katz and Smith assert that the rates charged by competitive and municipal systems are far lower than the rates recorded by the General Accounting Office in its various studies. While the GAO selected its sample to be representative of the entire industry, there was apparently no attempt by Katz and Smith to ensure that their competitive systems sample was equally representative. This methodology is equivalent to inferring from a sample of Georgetown homes that all residents of Washington are very well off. Any comparison with the rates charged by municipal systems is even more inappropriate. Unlike cable systems, municipalities can subsidize below-cost basic rates using their general powers of taxation.

provide as much guidance to the Commission on how to accomplish this task: The Commission should just go and do it. For example, Smith and Katz conclude that some national benchmark norm for replacement costs in each system category would be the best way to calculate the rate base. How should the Commission actually go about estimating these norms? Katz and Smith advise that these norms "will be determined through [an] annual Commission sample survey, and it should be augmented by special engineering analyses the Commission may conduct."⁴⁶ As with NAB's economists, the City of Austin et al.'s accountants simply assert that this task is easy.

Katz and Smith also contend that the only intangible asset that a cable operator possesses is its "market power." Thus, "all" that need be estimated is the replacement cost of the tangible assets. In the face of such naivete, it is not surprising that the "competitive" rates they subsequently calculate are so low.⁴⁷ As TCI has already noted in discussing the NAB effort, estimating the true replacement cost is anything but a mindless accounting exercise. See discussion at 30-34, supra. The City of Austin et al.'s accountants are equally unhelpful in describing to the Commission how it may easily estimate the allowed return on capital. "The Commission

⁴⁶ See Analysis for Cable, Appendix A at 13

⁴⁷ See id., Appendix B at Exhibits B-4 and B-7.

will perform analyses to determine a norm for the allowable return on capital..." See Analysis for Cable, Appendix A at 15.

Like NAB, Katz and Smith would permit some tailoring of the benchmarks to the local conditions. For example, apparently they would permit either the FCC or the local franchising authority to determine how much of the cable system's plant was "used and useful." Analysis for Cable at 12. But there can be greater deterrence to taking everyday entrepreneurial risktaking and to innovation than permitting the government to second-guess the wisdom of an investment decision after the fact.

In addition, if the rates resulting from application of the "benchmark" approach "provide the operator higher returns than might be provided using system-specific historical data . . . the capital expenditures used in the model could be based on actual historical costs for exception/appeal cases . . ." Id., Appendix A at 6 (note omitted). Here again, City of Austin, et al. are doing no less than inviting cost-of-service regulation for every regulable cable system nationwide. Put simply, the approach offered by the City of Austin et al.'s accountants suffers from all of the flaws of the NAB proposal. The Katz and Smith proposal to remedy rates of return that are too high by tying the operator's prices to its own costs would rapidly transform the benchmark approach into a conventional cost-of-service approach.

In its Appendix 2, the City of Austin, et al. present a proposal for the establishment of interim rates "while the Commission takes the steps necessary to establish a set of cost-based industry norms that can be used to derive rates at the local level." Id., Appendix 2 at 1. There are several basic reasons why the Commission should reject the proposed interim rates, however. First, if the Commission were to accept the suggestion to employ cost-based regulation, given the protracted proceedings that will necessarily arise, the "interim" is likely to be a very long time. Second, although the City of Austin, et al. seem concerned about possible actions on the part of cable operators that might reduce cable service quality, they seem oblivious to the effect of their own proposal on the quality of cable service programming and customer service -- express goals of the Act. Finally, as detailed below, the methods apparently used to establish the proposed interim rates are themselves highly suspect.

One of the four methods employed by the City of Austin et al. was to use estimates of the costs per channel for a sample of only thirteen cable systems. Unfortunately, it is difficult to determine how representative these cable systems are because their identities are not disclosed. More significantly, City of Austin et al. indicate that these

systems were not selected randomly.⁴⁸ In addition, the capital expenditure data used to obtain the estimates were based on original costs, yet the City of Austin et al. propose to use the resulting rates for all systems, regardless of when and at what cost their capital was acquired. Finally, in characterizing the pattern of rates for the thirteen systems, conveniently excludes the highest rate as "unrepresentative" while identifying the lowest as "particularly notable." Id., Appendix 2, at 2-3.

The City of Austin et al. next look at rates for ten communities in which there is overbuild competition. Id. at 3-4. The results for two of these communities, Orange County, Florida and Negaunee, Michigan, are dismissed, however, apparently on the grounds that their rates are too high.⁴⁹ Moreover, many of the systems in the sample appear to be very small, suggesting that they are unlikely to be representative of the cable industry. Finally, the City of Austin et al. do not even use the average of the rates for the overbuilt systems

48 The document indicates that these were the only systems "for which we received sufficient data from franchise authorities to enable us to perform the analysis." Id., Appendix B at 8, n.9.

49 The City of Austin et al. make no mention of Paramaus, New Jersey where the rates for the two systems are \$.77 and \$.92 per channel, respectively.

in its sample, preferring to give more weight to those (low) rates it likes and ignoring those (high) rates it does not.⁵⁰

The Appendix next looks at rates for nine municipal systems. Id. at 4. These systems are even smaller than the overbuilt systems, and thus even less representative. Moreover, the City of Austin et al. dismiss even some of their own observations on the grounds that some municipal systems "match rates charged by private systems, and . . . return the excess profits to the community." Id.

Finally, the City of Austin et al. cite a number of "other indicators" to highlight the correctness of its view. Id. at 4-5. First, they cite a Justice Department study concluding that about 50 percent of the basic rate increase since 1984 is attributable to cable's market power.⁵¹ By the study's own acknowledgment, however, one cannot have any confidence in the precise estimates offered. In some statistical tests conducted by the author, the results disappear entirely.⁵² And in what was probably the author's best estimate of the "market power" effect, the imprecision is

50 It is difficult to be precise in criticizing an approach to rate setting that plays as fast and loose with its own facts as does the City of Austin et al.'s.

51 Rubinovitz, "Market Power and Price Increases for Basic Cable Service Since Deregulation," Paper presented at the 1991 Telecommunications and Policy Research Conference (Sept. 1991).

52 See id. at 20, n.29.

such that market power might only explain 3 percent of the basic rate increase.

The City of Austin, et al. also cite the Katz-Smith comparison of pay and basic rates. Analysis of Cable, Appendix B at 1-2. As already discussed, correctly interpreted within the Katz-Smith framework, this is evidence for the proposition that basic rates are competitive. Finally, the City of Austin et al. note that the "monopoly rent" component of the asset values of cable systems is substantial;⁵³ this results from the erroneous presumption that all intangible assets of cable operators are "monopoly rents."

In short, the City of Austin et al. have based their proposed interim rates for more than 10,000 systems on observations from only 32 admittedly unrepresentative communities, where the "data must be approached carefully," and where the "limited data...may be more useful as a check on the foregoing than anything else." Id., Appendix 2 at 3-4. If the Commission needed any additional persuading of the potential for local governments to overreach in their re-regulatory efforts, it need look no further.

53 Id. at 4-5.

B. The Basic Tier

1. Components of the Basic Service Tier

Section 623(b)(7)(A) sets out the components of the basic service tier. Act, § 623(b)(7)(A)(i), (ii), (iii). They include the broadcast signals (other than the signals of superstations) and the PEG channels.⁵⁴ While a cable operator

54 Contrary to the views expressed by NATOA and a coalition of cities, the 1992 Cable Act implicitly amended the ACLU definition of basic service. See American Civil Liberties Union v. FCC, 823 F.2d 1554 (D.C. Cir. 1987), cert. denied Connecticut v. FCC, 485 U.S. 959 (1988); NATOA at 68, n.36; City of Austin, et al. An effort to alter the ACLU definition of basic cable services is evinced in both the letter and the spirit of the Act. First, the plain language of the Act itself repeatedly references "a basic tier," and "the basic tier" Act, § 623(b)(7). This language indicates, as the Notice properly recognized, an understanding "that there be a single basic tier." Notice at ¶ 13. Second, the overall policy of the Act is to provide consumers with an affordable basic service tier: "The purpose of Section 3 is to create a tier of low cost basic cable service." H.R. Rep. No. 628, 102d Cong., 2d Sess. 83 (1992) ("House Report"). Third, as the Notice correctly indicated, the utility of the anti-buy-through provisions of Section 623(b)(8) is minimized if there is more than one basic service tier. Finally, the ACLU analysis is inappropriate in the instant proceeding. The ACLU court was concerned that the FCC had defined the basic service tier in one manner, and that the plain language of the statute warranted a different definition. See 823 F.2d at 1565. Here, the plain words of Section 623 evince a Congressional intent for one single basic tier. Furthermore, under ACLU's Chevron analysis, since the Congress did not here lay out basic service with the same "crystalline clarity", the FCC, as the expert agency may step in and fill out the gaps of the definition. The Commission must interpret the statute as amending ACLU.